

MOTION FILED
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No. 88-1400

In The
Supreme Court of the United States
October Term, 1988

FRANCHISE TAX BOARD,

Petitioner,

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL
CHEMICAL INDUSTRIES PLC,

Respondents.

On Petition From The United States Court Of
Appeals For The Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS
CURIAE IN SUPPORT OF PETITIONER AND BRIEF
AS AMICUS CURIAE IN SUPPORT OF
PETITIONER'S WRIT FOR CERTIORARI

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**MOTION FOR LEAVE TO FILE AMICUS CURIAE
BRIEF IN SUPPORT OF PETITIONER**

**TO THE HONORABLE CHIEF JUSTICE AND
THE ASSOCIATE JUSTICES OF THE
SUPREME COURT OF THE UNITED STATES:**

Pursuant to Rule 36.1, the Multistate Tax Commission respectfully moves the Court for leave to file the accompanying amicus curiae brief in support of petitioner. The Multistate Tax Commission has requested the written consent of all parties to the case. The consent of respondent Imperial Chemical Industries PLC was requested, but refused at this stage¹.

The Multistate Tax Commission (hereinafter "Commission") is an organization of states, a main purpose of which is to bring about some order to the state taxation of multistate businesses. The Commission was created under the Multistate Tax Compact and currently has nineteen full members and ten associate members.² Its

¹ Counsel for respondent Imperial Chemical Industries PLC, however, did indicate that said respondent would consent to the Commission filing an amicus curiae brief, if and when the substantive merits of its case were to be reviewed by this Court.

² The current full members are the states of Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Minnesota, Missouri, Michigan, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, and Washington. The associate members are the states of Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, New Jersey, Ohio, Pennsylvania and Tennessee. This brief should not be read to reflect the views of any member State that files or joins the filing of a separate brief in this case.

purposes are stated in the Compact: to facilitate proper determination of state and local tax liability of multistate taxpayers; to promote uniformity and compatibility in state tax systems; to facilitate taxpayer convenience and compliance in the filing of tax returns and in tax administration; and to avoid duplicative taxation. The validity of the Multistate Tax Compact was recognized by this Court in *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978).

The issues presented in this case and their resolution by the Court are of substantial consequence to the Commission's members because those issues bear directly upon the method by which tax disputes between states and taxpayers are adjudicated. Resolution of this case will affect far more than the issue of whether California may be sued in federal district court in Illinois by a foreign parent corporation whose domestic subsidiary corporation is liable to California for a franchise tax. The Commission is gravely concerned that the decision by the Seventh Circuit, unless reversed, will cause havoc with the states' tax administration systems in that a parent corporation, which itself is not liable or subject to a state tax, will have standing to bring an action in federal court against a state where the state tax is imposed upon the corporation's subsidiary.

Under the opinion of the Seventh Circuit, such an action would not be barred by a lack of standing, nor by the Tax Injunction Act, nor by principles of comity or federalism. Suits by nontaxpayers, both foreign and domestic, could proliferate against the states if the decision of the Seventh Circuit is allowed to stand.

WHEREFORE, it is respectfully requested that leave be granted for the Multistate Tax Commission to file the accompanying amicus curiae brief addressing the issue of why this case should be heard.

Respectfully submitted,

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Dated: March 22, 1989

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QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary; and

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. 1341) or the principle of comity which underlies the Act.

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STATEMENT OF INTEREST

The Multistate Tax Commission (the "Commission") is the administrative arm of the Multistate Tax Compact (the "Compact"). The Compact has been entered into by 18 member and 10 associate member states and the District of Columbia. Its purposes as stated in the Compact are to facilitate proper determination of state and local tax liability of multistate taxpayers, to promote uniformity or compatibility of tax systems, to facilitate taxpayer convenience and compliance, and to avoid duplicative taxation. The validity of the Multistate Tax Compact which established the Multistate Tax Commission was recognized by this Court in *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978).

To further the purposes of the Compact, the Commission conducts joint audits for member states. The Commission maintains audit offices in New York, Chicago and Houston, a legal office in Los Altos, California, and a headquarters office in Washington, D.C. Under the holding of the Seventh Circuit in this case, it is possible that each of the states participating in the joint audit program could be required to defend assessments proposed or made under their respective laws in the federal courts of anyone of these jurisdictions. The interest of the Multistate Tax Commission in this matter is direct and obvious. If the Seventh Circuit's decision in this case is allowed to stand, it could hamstring the Commission audits and the tax collecting efforts of each of the member states by taxpayers seeking relief in federal district courts sitting in one state regarding the legality of assessments and tax administration procedures being conducted on behalf of state tax agencies located in other states.

SUMMARY OF ARGUMENT

The Court should grant the petition for the writ of certiorari because of the split in the federal circuits. Failure to do so and to provide clarity in this area will encourage forum shopping and increase the burden of the federal courts. Furthermore, the Court should address the question of the extent of the prohibition established by the Tax Injunction Act or, in the alternative, decide whether the principle of comity extends to the circumstances presented here. Finally, the Court should resolve whether a shareholder injury arises as the result of the application of a tax to the corporation in which the stock is owned.

ARGUMENT

I.

THERE IS AN URGENT NEED TO RESOLVE THE CONFLICT BETWEEN THE SEVENTH CIRCUIT'S DECISION IN THIS CASE AND DECISIONS OF THE SECOND AND NINTH CIRCUIT COURTS OF APPEAL.

The Ninth Circuit has twice decided that a foreign company shareholder has no standing to contest the state tax liability of its American subsidiary. *Shell Petroleum, N.V. v. Graves* (9th Cir. 1983) 709 F.2d 593, cert. den. 464 U.S. 1012 (1983), and *EMI, Ltd. v. Bennett* (9th Cir. 1984) 738 F.2d 994, cert. den. 469 U.S. 1073 (1984). The Second Circuit reached the same conclusion. *Alcan Aluminium Ltd. v. FTB*, 558 F.Supp. 624 (S.D.N.Y. 1983), affd. mem. 742 F.2d 1430 (2nd Cir., 1983), cert. den. 464 U.S. 1041

(1984). The Seventh Circuit in the instant cases has determined that the foreign shareholder does have standing. Amicus curiae respectfully urges the Court to reconcile the differences between the Circuits.

The circumstances involved in these cases demonstrate the need for reconciliation. The lack of a uniform rule on standing will continually give rise to the type of judicial forum shopping plainly evident in this case; and that lack of uniformity will further burden the already strained resources of the federal judiciary. California, the state asserting the tax, is in the Ninth Circuit. New York, where the Franchise Tax Board has an audit office and where Alcan unsuccessfully brought its first federal suit, is in the Second Circuit. Chicago, where the Franchise Tax Board also has an office and where this action was brought, is in the Seventh Circuit. The Franchise Tax Board also has an audit office in Houston. If Alcan had been unsuccessful in the Seventh Circuit, there is little doubt that an action in the Fifth Circuit would have been brought.¹

The mischief which can result from this divergence among the Circuits and the opportunities for forum shopping are obvious. It is not a risk peculiar to California.

¹ Alcan was audited by both the New York and Chicago offices of the California Franchise Tax Board but has not been audited by the Board's Houston office. *Alcan Aluminium Ltd v. FTB*, 558 F. Supp. 624 and Stipulation of Facts as Revised ¶ 16, Docket #84-C-6932 (Judge Williams) N-D Ill. There is no reason to believe this fact would forestall a Fifth Circuit action. ICI was never audited by the Board's Chicago office but nevertheless brought this action in the Seventh Circuit. Joint Stipulation of Facts Sec. 9 Docket #84-C-8906 (Judge Williams) N.D. Ill.

Every state is subject to this risk.² The Seventh Circuit has in effect conceded that its decision in this case is in conflict with decisions of the Second and Ninth Circuits. The concession is unnecessary as the conflict is obvious. Amicus urges the Court to resolve this conflict.

II.

THE DECISION BELOW IS INCONSISTENT WITH THE OBJECTIVES OF THE TAX INJUNCTION ACT AND THE PRINCIPLES OF COMITY ON WHICH THE ACT IS BASED.

The Tax Injunction Act, 28 U.S.C. 1341, provides that:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

There appears to be no question that the corporations in which respondents are shareholders have a plain, speedy and efficient remedy in the California courts. They have this remedy because they are the California taxpayers. It also appears to be uncontroverted that the taxpayers would be barred from bringing these federal actions by the Tax Injunction Act. Nonetheless, it is alleged that there is no remedy in the state courts. This allegation is apparently based on the fact that respondents are not California taxpayers and therefore they have no standing in California's courts. On this basis the

² A survey by the State of Minnesota in 1986 found that 18 states maintain out-of-state audit offices (15 in Chicago). Subsequent to that study both Minnesota and New Jersey are known to have added out-of-state audit offices.

Seventh Circuit finds that these lawsuits are not barred by the Tax Injunction Act.

The Tax Injunction Act requires that there be "a plain, speedy and efficient remedy . . . in the courts of such state." In this case, it is clear that the corporate taxpayers have such a remedy. The case thus presents the question of whether the existence of a state remedy in the appropriate party's hands bars a federal action by someone else.

The Tax Injunction Act was enacted in 1937 because of concerns that taxpayers were seeking increased involvement by federal courts, based upon diversity of citizenship, in state tax matters.³ In introducing the bill that ultimately became the Tax Injunction Act, Senator Bone explained:

"The existing practice of the Federal courts to entertain tax-injunction suits make[s] it possible for foreign corporations [exercising the diversity jurisdiction] to withhold from a State and its governmental subdivisions taxes in such vast amounts and for such long periods as to disrupt State and county finances, and thus make it possible for such corporations to determine for themselves the amount of taxes they will pay. 81 CongRec. 1416 (1937)."

The Senate Report on the bill states, in part:

"It is the common practice for statutes of the various States to forbid actions in State courts to enjoin the collection of State and county taxes unless the tax

³ A thorough discussion of the background of the Tax Injunction Act was presented by Justice Brennan (joined in by Justice Marshall, Justice Stevens and Justice O'Connor) in a concurring opinion in *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 at 125-133 (1981).

law is invalid or the property is exempt from taxation, and these statutes generally provide that taxpayers may contest their taxes only in refund actions after payment under protest. This type of State legislation makes it possible for the States and their various agencies to survive while long-drawn-out tax litigation is in progress. If those to whom the Federal courts are open may secure injunctive relief against the collection of taxes, the highly unfair picture is presented of the citizen of the State being required to pay first and then litigate, while those privileged to sue in the Federal courts need only pay what they choose and withhold the balance during the period of litigation.

"The existing practice of the Federal courts in entertaining tax-injunction suits against State officers makes it possible for foreign corporations doing business in such States to withhold from them and their governmental subdivisions, taxes in such vast amounts and for such long periods of time as to seriously disrupt State and county finances. The pressing needs of these States for this tax money is so great that in many instances they have been compelled to compromise these suits, as a result of which substantial portions of the tax have been lost to the States without a judicial examination into the real merits of the controversy." S Rep No. 1035, at 1-2 (1937).

The above quoted material clearly establishes a legislative concern that foreign out-of-state corporations were pleading diversity to obtain access to federal courts and to avoid state courts. This case raises the question of whether the use of the "instrumentality" of a subsidiary should allow for avoidance of the provisions of the Tax Injunction Act. There appears to be no reason why the creation of a subsidiary should be any more effective than

the pleading of diversity. The harm to the states is identical, only the strategy is different.

As support for its position the Seventh Circuit cites its earlier decision in *Alcan Aluminium Ltd. v. Department of Revenue (Alcan-Oregon)*, 724 F.2d 1294 (7th Cir. 1983), which in turn cited *Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107 (9th Cir. 1982). In the *Capitol Industries* case the Ninth Circuit ultimately resolved the standing issue in favor of California (see *EMI Ltd. v. Bennett, supra*) rendering its construction of the Tax Injunction Act irrelevant. No appeal was taken in *Alcan-Oregon* so this Court has had no occasion to review this question. It is now presented with that opportunity. Amicus urges it to do so.

If the Tax Injunction Act does not specifically bar this action, then consideration should be given to whether the principles of comity require the federal judiciary to abstain. As this Court has noted:

[The Tax Injunction Act] "... 'has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations.' *Tully v. Griffin, Inc.*, 429 U.S. (68), at 73. This last consideration was the principal motivating force behind the Act; this legislation was first and foremost a vehicle to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981).

In *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981), this Court had occasion to consider the implications of the Tax Injunction Act and comity in conjunction with a suit for damages brought under 42 U.S.C.

1983 based upon the alleged invalidity of a state tax statute. Although an action for damages is not barred directly by the Act, the Court held such an action is barred under principles of comity. As Justice Rehnquist stated:

"The post-Act vitality of the comity principle is perhaps best demonstrated by our decision in *Great Lakes Dredge & Dock Co. v. Huffman*, 319 US 293, 87 L Ed 1407, 63 S Ct 1070 (1943). Several Louisiana taxpayers brought an action in Federal District Court seeking a declaratory judgment that the state tax law as applied to them was unconstitutional and void. Although [Section] 1341 was raised as a possible bar to the suit, as it has been raised in this case, 'we [found] it unnecessary to inquire whether the words of the statute may be so construed as to prohibit a declaration by federal courts concerning the invalidity of a state tax.' 319 US, at 299. Instead, 'we [were] of the opinion that those considerations which have led federal courts of equity to refuse to enjoin the collection of state taxes, save in exceptional cases, require[d] a like restraint in the use of the declaratory judgment procedure.'

• • •

"The Court's reliance in *Great Lakes* upon the necessity of federal-court respect for state taxing schemes demonstrates not only the post-Act vitality of the comity principle, but also its applicability to actions seeking a remedy other than injunctive relief. The focus was not on the specific form of relief requested, but on the fact that in every practical sense [it] operate[d] to suspend collection of the state taxes until the litigation [was] ended." 454 U.S. at 110 and 111.

In the instant case the issue is not the remedy sought but the party seeking it. However, the considerations are the same. The petitioner in *Fair Assessment* argued:

"... that damages actions are inherently less disruptive of state tax systems than injunctions or declaratory judgments, and therefore should not be barred by prior decisions of this court." *Supra* at 113.

Justice Rehnquist responded:

"We disagree. Petitioners will not recover damages under [Section] 1983 unless a district court first determines that respondents' administration of the County tax system violated petitioners' constitutional rights. In effect, the district court must first enter a declaratory judgment like that barred in *Great Lakes*. We are convinced that such a determination would be fully as intrusive as the equitable actions that are barred by principles of comity. Moreover, the intrusiveness of such ?1983 actions would be exacerbated by the nonexhaustion doctrine of *Monroe v. Pape*, 365 US 167 (1961). Taxpayers such as petitioners would be able to invoke federal judgments without first permitting the State to rectify any alleged impropriety."

The same result would be reached in this case though the operative question is the party not the relief sought. This Court is urged to decide whether or not comity dictates abstention.

III.

SEVENTH CIRCUIT'S DECISION CREATES AN IRRATIONAL EXCEPTION TO THE STOCKHOLDER STANDING RULE

It is settled that a stockholder is not personally injured by a wrong done to the corporation in which he

holds an interest; his rights are derivative. *Pittsburgh & W. V. R. v. U.S.*, 281 U.S. 479, 487 (1930). Thus, if the cause of action is the corporation's, the corporation is a necessary party, and relief must be sought either directly by the corporation or through a derivative action brought on its behalf. Cf., *Ross v. Bernhard*, 396 U.S. 531 (1970); *Koster v. Lumbermans Mutual Co.* 330 U.S. 518, 522-523 (1947); *Meyer v. Fleming*, 327 U.S. 161, 167 (1946). The rule cannot be avoided by an allegation of injuries to the stockholder which are the indirect result of wrongs against the corporation. See, *Pittsburgh & W. V. R.*, *supra*, at 486-487. An exception to the rule exists, however, when the shareholder has a direct, personal interest in a cause of action. *Buschmann v. Professional Men's Ass'n.*, 405 F.2d 659 (7th Cir. 1969); *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893 (5th Cir. 1968)

The Seventh Circuit has found such an exception in this case on the theory that the California tax at issue burdens foreign companies' decisions to conduct business through subsidiaries. It has concluded that this "burden" on the foreign companies' decision-making process gives rise to a direct and personal injury sufficient to confer standing.⁴

The logical consequence of the decision below is that in every situation in which a shareholder wishes to bring a cause of action based upon an alleged wrong to the corporation, it can claim to have a direct and personal injury by reason of the fact that the same wrong affects its

⁴ The "reach" which the Seventh Circuit has made is demonstrated by the fact that respondents themselves never argued this injury.

"decision" to conduct a particular activity through the corporation. This is true regardless of whether foreign, interstate or intrastate commerce is involved. The logic of the Seventh Circuit's decision may also extend to permitting domestic parent corporations to have standing in federal district courts in one state to challenge the imposition of state taxes imposed upon their subsidiaries in other states. Amicus curiae submits that this Court should consider whether the "decision" to operate through a subsidiary establishes a direct and personal right sufficient for standing purposes.

CONCLUSION

The Seventh Circuit's decision breaks new ground in areas which directly affect the administration and collection of state taxes. First, it is inconsistent with prior decisions of the Second and Ninth Circuits which this Court has allowed to stand. Second, it construes the Tax Injunction Act in a manner which may open the federal court system to state tax litigation in circumstances that are inconsistent with the principles of federalism, as well as sound public policy considerations. Third, it refuses to apply the principles of comity to preclude a nontaxpayer from seeking federal injunctive and declaratory relief against state tax authorities. Fourth and finally, it may create a course of action for a shareholder any time an injury is alleged to a corporation because of its potential to affect the shareholder's "decision" to participate in an activity through a corporation. Amicus curiae urges the court to grant certiorari and review all of these questions

so that it can establish clear rules for taxpayers, the states
and the federal courts.

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